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CHARLES ELMORE CRO
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IN THE

Supreme Court of the United States

October Term, 1936

No. 97

THE UNITED STATES, *Petitioner,*

v.

PERCY K. HUDSON

On Writ of Certiorari to the Court of Claims

BRIEF OF AMICUS CURIAE

BREWSTER & MACLEAN,
AMICUS CURIAE,
Washington, D. C.

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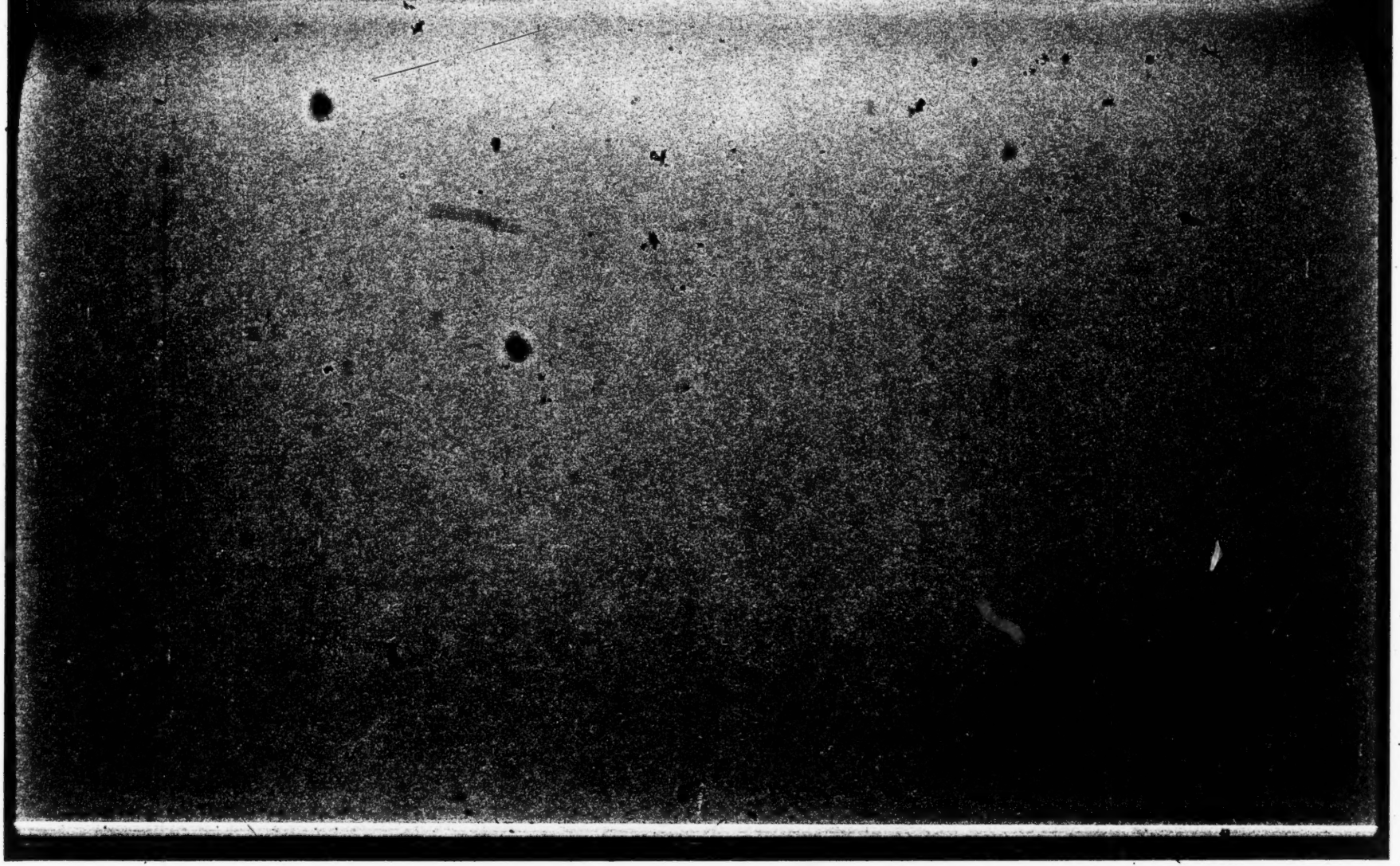

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STATEMENT

The above suit is to recover taxes paid under the Silver Purchase Act of 1934 (48 Stat. 1178) which levied a stamp tax on the transfer of any interest in silver bullion. The tax so imposed was 50 per centum of the excess of the sale price over cost and specified expenses. The Act was approved June 19, 1934 and was made retroactive with respect to transfers made on and after May 15, 1934. The taxes sought to be recovered are with respect to transfers made by respondent during the period the Act applied retroactively.

In the Court below the Government contended that the tax was valid under both the monetary and the taxing

powers of Congress. With respect to the taxing power it was argued "that in its practical effect the tax was one upon income, and that being an income tax, it can be imposed retroactively."[1]

The question of how far Congress may go in imposing taxes retroactively has become, and will continue to be, of great importance to taxpayers, and the decision in this case upon that issue necessarily will be of constructive assistance in the framing of future tax legislation. The decision of necessity will also bear importantly upon the question of retroactivity presented with respect to the so-called "tax upon unjust enrichment," imposed by Title III, Revenue Act of 1936,[2] which was designed to recoup for the Government the taxes imposed under the Agricultural Adjustment Act and held to be unconstitutional in *United States* v. *Butler,* 297 U.S. 1. While the provisions of the Act denominate it as a tax upon net income, it is in fact an excise imposed retroactively upon the sale of arti-

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[1] *Hudson* v. *United States,* 12 F. Supp. 620, 623.

[2] The "unjust enrichment" tax of 80 per cent is denominated a tax upon that portion of net income (a) from the sale of articles to the extent that such income is attributable to shifting to others the burden of any unpaid Federal excise tax imposed with respect to such articles; (b) from reimbursement from vendors of Federal excise tax burdens which had been included in the price paid for goods and which the taxpayer in turn had shifted to his vendees; and (c) from refunds and credits for Federal excise taxes erroneously or illegally collected, which had been shifted to others. It disregards any loss arising from other transactions of the taxpayer and whether the taxpayer had a taxable net income for the taxable year as a whole (§501 (l)).

cles with respect to which the unconstitutional processing tax was imposed.[3]

The observations in this brief will be confined to what are conceived to be the principles by which the constitutionality of the retroactive exercise of the taxing power should be tested.

ARGUMENT

The actual result which follows from the exaction of a tax should be the determining factor as to whether or not its imposition is so arbitrary and capricious as to violate the due process clause. It is the practical effect of the tax and not what Congress may have called it which determines its nature.[4] The mere fact, therefore, that the tax in question is measured by the income or profits derived from a particular transaction does not mean that it may be retroactively applied.

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[3] The imposition of the "unjust enrichment" tax cannot be justified as a necessary adjunct in order to insure the effective exercise of the taxing power (*Purity Extract Co.* v. *Lynch*, 226 U. S. 192, 201; *Milliken* v. *United States*, 283 U. S. 15, 24) because it has no prospective application, at least so far as the invalidated processing tax is concerned. So far as it is based upon the invalidated processing tax, the "unjust enrichment" tax applies only to taxable years ending during the calendar year 1935, and the period ending January 6, 1936, which was the date of the decision in the *Butler* case (§501, 504, Revenue Act, 1936.)

[4] *Nicol* v. *Ames*, 173 U. S. 509, 515; *Shaffer* v. *Carter*, 252 U. S. 37, 55; *St. Louis S. W. Ry.* v. *Arkansas*, 235 U. S. 350, 362; *Mountain Timber Co.* v. *Washington*, 243 U. S. 219, 237; *Dawson* v. *Kentucky Distilleries Co.*, 255 U. S. 288, 292.

I

Retroactive Taxation Has Been Upheld Only Where Pursuant to an Established Policy

The retroactive application of taxes has been upheld with respect to income for the current year [5] where such application was pursuant to an established policy of taxation well understood by those taxed,[6] and the taxpayer necessarily must assume the risk of an "increase in the tax burden which might result from carrying out the established policy." [7]

The ratification of taxes and impositions erroneously as-

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[5] *Burnet* v. *Wells*, 289 U. S. 670, 682-683; *Cooper* v. *United States*, 280 U. S. 409; *Reinecke* v. *Smith*, 289 U. S. 172.

[6] *Stockdale* v. *Insurance Companies*, 20 Wall. 323; *Lake Shore, etc., Railroad Co.* v. *Rose*, 95 U. S. 78; *Western Union Railroad Co.* v. *United States*, 101 U. S. 543; *Milliken* v. *United States*, 283 U. S. 15; *Patton* v. *Brady*, 184 U. S. 608; *Hecht* v. *Malley*, 265 U. S. 144; *Phillips* v. *Dime Trust and Safe Deposit Co.*, 284 U. S. 160, 166; *Fawcus Mach. Co.* v. *United States*, 282 U. S. 375. In *Brushaber* v. *Union Pac. R. R.*, 240 U. S. 1, and *Lynch* v. *Hornby*, 247 U. S. 339, the adoption of the Sixteenth Amendment, especially in the light of the income tax acts which preceded it, established a policy to tax income "from whatever source derived." See also cases in Note 5. In *R. Hoe & Co.* v. *Commissioner* (C. C. A. 2d), 30 F. (2d) 630, involving war profits taxes under the Revenue Act of 1918, the question of retroactivity was not presented or decided. *Updike* v. *United States* (C. C. A. 8th), 8 F. (2d) 913, cer. den. 271 U. S. 661, involved only the retroactive application of an increase in excess profits taxes over those provided in previous acts.

[7] *Milliken* v. *United States*, *supra*, p. 23; *MacLaughlin* v. *Alliance Ins. Co.*, 286 U. S. 244, 250.

sessed does not involve the question of retroactivity. Such cases turn upon the right of the principal to ratify the acts of an agent, which were beyond the scope of his delegated powers, but which might have been delegated by the principal in the first instance[8]

The cases in which special assessments for past benefits have been upheld justify such assessments in their retroactive application upon several grounds.[9] The element of an established system of taxation is present, however, in that, historically, the cost is frequently charged to the abutting property in proportion to the benefit conferred. The benefit being a continuing one, the cost may be imposed upon the beneficiaries whether before or after the improvements are made.[1]

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[8] *United States* v. *Heinszen & Co.*, 206 U. S. 370; *Rafferty* v. *Smith, Bell & Co.*, 257 U. S. 226; *Citizens National Bank* v. *Kentucky*, 217 U. S. 443; *Charlotte Harbor Ry.* v. *Welles*, 260 U. S. 8; *Graham* v. *Goodcell*, 282 U. S. 409, 429. The distinction between ratifying an assessment made without authority and imposing a new tax retroactively is pointed out in the *Charlotte Harbor Ry.* case where it distinguished *Forbes Boat Line* v. *Board of Commissioners*, 258 U. S. 338, on the ground that in the *Forbes Boat Line* case there was no charge for the use of a Government canal at the time such use was availed of, and therefore the Legislature could not retroactively impose a charge for such use. See *William Danzer Co.* v. *Gulf R. R.*, 268 U. S. 633, 637.

[9] *Wagner* v. *Baltimore*, 239 U. S. 207; *Charlotte Harbor Ry.* v. *Welles, supra*; *Seattle* v. *Kelleher*, 195 U. S. 351.

[1] In *Seattle* v. *Kelleher, supra*, this Court answered the contention that the assessment for past benefits could not be constitutionally laid upon property in the hands of a bona fide purchaser who acquired the property after the improvements were made but prior to assessment, by saying that

II

A Retroactive Tax Is Invalid When Laid Upon an Activity or with Respect to a Privilege not Theretofore Specifically Taxed.

Where the tax is laid retroactively upon an activity or in respect to a privilege not theretofore a subject for special taxation, this Court has held that such tax may not be retroactively applied.

In *Nichols* v. *Coolidge,* 274 U.S. 531, the Commissioner sought to include in the gross estate of Mrs. Coolidge the value of property transferred in trust in 1907, on the theory that under the Revenue Act of 1918 such a transfer was one intended to take effect in possession or enjoyment at or after deah. The Federal policy of estate taxation was first adopted in the Revenue Act of 1916. At the time of the transfer in 1907, therefore, there was no established system or policy of estate taxation by which the settlors could or should have known that a transfer intended to take effect at or after death might be made the basis of a tax. This Court concluded that to include in the gross estate the value of property so transferred was arbitrary, capricious and amounted to confiscation. In *Coolidge* v. *Long,* 282 U.S. 582, the same trust was considered with respect to the retroactive application of the Massachusetts inheritance tax. The trust was created on July 29, 1907. The first relevant statute imposing inheritance taxes upon such transfers was approved on June 27, 1907, about 30

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such a purchaser could not buy without notice—that the improvements were visible upon the ground and it was for the purchaser to inquire whether they had been paid for.

days prior to the transfer, but was not effective until September 1, about 5 weeks subsequent thereto.[2]

The same principle was applied in *Blodgett* v. *Holden*, 275 U.S. 142, 276 U.S. 594, and *Untermyer* v. *Anderson*, 276 U.S. 440. The gift tax imposed by the Revenue Act of 1924 was new to the Federal system of taxes. In the *Untermyer* case the gift was made in May, 1924, about a week before the passage of the Revenue Act which for the first time imposed a tax upon such gifts. The Court held (p. 445) that "so far as applicable to bona fide gifts not made in anticipation of death and fully consummated prior to June 2, 1924" its provisions violated the due process clause.

The principle was also applied in the attempt retroactively to impose tolls for the use of a Government canal in *Forbes Boat Line* v. *Board of Commissioners, supra.* In this case in the Court below the Government contended that the *Forbes Boat Line* case turned upon the principle of contractual relations between the user of the canal and the State of Florida, basing this argument on the use in the opinion in the *Forbes Boat Line* case of the words "without any promise of reward" and "gratuitous deposit of rolls". The analysis of the *Forbes Boat Line*

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[2] No question of retroactivity is involved in the inclusion of the value of estates by the entirety or the interest of a decedent in a joint tenancy, even though such estate or interest was created before 1916. It is the shifting of an economic benefit at death to which the tax applies. *Third Nat. Bank* v. *White*, 287 U. S. 577. There was no shifting of economic benefits at death in *Nichols* v. *Coolidge*. Prior to the death of Mrs. Coolidge the settlors had divested themselves of their entire interest in the property.

case, however, in *Charlotte Harbor Ry.* v. *Welles, supra* (see Note 8), indicates that the underlying principle involved was the retroactive imposition of a tax upon a privilege which, when exercised, the user had no reason to believe was subject to a charge.[3] This was a recognition of the rule that had the taxpayer known that such a tax would be laid, or might reasonably be anticipated, he might

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[3] The case of *Billings* v. *United States*, 232 U. S. 261, concerned the validity of an excise upon the use of foreign-built yachts imposed by the Tariff Act of August 5, 1909. The tax was to be levied and collected annually on September 1st. It was held that the tax was upon the use for any time during the year. The use between August 5, 1909, the effective date of the Act, and September 1, 1909, when the tax was due, subjected such use to the whole tax, the test being "the fact of use, not its extent or its frequency" (p. 280). Use for but one day during the above period would have had the same effect. In this sense the Act was prospective in its application. The statement in the opinion (p. 282) that the Act would not be beyond the power of Congress to adopt, even if it be conceded that it had, in some respects, a retroactive effect, was not necessary to the decision of the case. Cf. the later decisions in *Nichols* v. *Coolidge* and *Untermyer* v. *Anderson*. In *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, the *tax* was laid *prospectively* upon the privilege of doing business in a corporate capacity. The measure of the tax was a percentage of the net income for the year. The Act was passed August 5, 1909. The only element of retroactivity involved, therefore, was with respect to the *measure* of the tax, and then only in the first year of its application. In determining the constitutionality of the tax (p. 165) the Court clearly points out the distinction between the *subject* of the tax and the *measure* of it.

have avoided it by refraining from exercising the privilege.[4]

III

The Silver Purchase Tax Is Invalid as Applied Retroactively

Applying the foregoing principles to the tax involved in this case it appears that for the first time, on June 19, 1934, a tax was specifically directed at the particular privilege of transferring an interest in silver bullion. There is no question as to the right of Congress to impose such a new tax prospectively, but to impose it retroactively upon transactions completed prior to the effective date of the taxing Act brings the question of the arbitrariness of the retroactive imposition squarely within the principle which the Court applied in *Nichols* v. *Coolidge* and *Untermyer* v. *Anderson*. It is true that any gain from such a transaction would be subject to the ordinary income tax and respondent can be charged with notice that Congress had the right to change the rate or the method of computation of the tax as generally applied to all income-producing activities. When Congress, however, without warning, singles out one particular income-producing activity for a special tax not applicable generally, it is obvious that it is arbitrary so far as such tax applies retroactively to transactions completed before it was imposed.

In its petition for certiorari in this case (p. 4) petitioner states that the transfers here involved were already subjected to a transfer tax under Subdivision 4, Schedule A, Title VIII, Revenue Act of 1926. So much of Subdivision

[4] *Lewellyn* v. *Frick*, 268 U. S. 238, 252.

4 as is material is found below.[5] It is not clear just what the purpose of this reference is unless it be to establish a policy of taxation which might reasonably be supposed to put the respondent upon notice with respect to the taxation of transfers made prior to the passage of the Silver Purchase Act. If such is the purpose we submit that the transfers involved in this case were not subject to tax under Schedule A-4 above referred to.

It will be noted that the tax is not imposed specifically upon the transfer of any interest in silver bullion, but applies only to sales or agreements to sell products or merchandise at or under the rules or usages of an exchange, board of trade or other similar place, and then only upon sales and agreements for future delivery. In the instant case it does not appear that the transfer was made at or under the rules or usages of any exchange, board of trade or similar place, nor was it a sale or agreement to sell a product or commodity for future delivery. What respondent sold was his interest in a contract under

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[5] Subdivision 4 of Schedule A was amended by §726(a), Revenue Act of 1932, and §612(a), Revenue Act of 1934, with respect to the rate of tax only. The present rate is 3 cents. So far as applicable, the Subdivision as amended is as follows:

"4. Produce, sales of, on exchange: Upon each sale, agreement of sale, or agreement to sell (not including so-called transferred or scratch sales), any products or merchandise at, or under the rules or usages of, any exchange, or board of trade, or other similar place, for future delivery, for each $100 in value of the merchandise covered by said sale or agreement of sale or agreement to sell, 3 cents, and for each additional $100 or fractional part thereof in excess of $100, 3 cents: * * *"

which a third party was obligated to make delivery of silver bullion some time in the future.[6]

It is submitted that the tax under Schedule A-4 not only did not apply to the transfers involved in this case, but could not reasonably be construed as establishing a policy for singling out such transfers for special taxation or as a warning to respondent that the tax involved in this case might later be imposed.

CONCLUSION

From the foregoing it appears that this Court has been consistent in its application of the due process clause with respect to retroactive impositions under the taxing power. The principle involved is obviously one of notice,—of being forewarned. The taxpayer may not complain of a retroactive imposition, not otherwise arbitrary or capricious, which might reasonably be anticipated. But a tax imposed for the first time upon a particular privilege theretofore enjoyed without charge, a reaching back so as to burden unexpectedly a completed transaction, is obviously arbitrary and unreasonable. To tax retroactively a completed transaction without warning is to change the rules of the game after the game is finished.

We respectfully submit that so far as the retroactive exercise of the taxing power in this case is concerned, the

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[6] It will also be noted that the tax imposed by Subdivision 4 of Schedule A is not upon the profits derived from the sale, but is measured by the value of the merchandise involved, without regard to any profit or loss which might accrue.

decision of the Court of Claims was correct and should be affirmed.

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